Y 1.1/8:97-917

OCT 2 8 1982

Union Calendar No. 572

97th Congress, 2d Session - - - - - - - - - - - - House Report No. 97-917

COMPLETED ORIGINAL

IMPROVING THE FINANCIAL MANAGEMENT AND AUDITING OF FEDERAL ASSISTANCE PROGRAMS: THE "SINGLE AUDIT" CONCEPT

THIRTY-EIGHTH REPORT

BY THE

COMMITTEE ON GOVERNMENT OPERATIONS

together with

ADDITIONAL VIEWS

Y1.1/8:97-917

OCTOBER 1, 1982.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

---

U.S. GOVERNMENT PRINTING OFFICE

99-303O WASHINGTON : 1982

I

COMMITTEE ON GOVERNMENT OPERATIONS

JACK BROOKS, Texas, *Chairman*

L. H. FOUNTAIN, North Carolina
DANTE B. FASCELL, Florida
BENJAMIN S. ROSENTHAL, New York
DON FUQUA, Florida
JOHN CONYERS, JR., Michigan
CARDISS COLLINS, Illinois
JOHN L. BURTON, California
GLENN ENGLISH, Oklahoma
ELLIOTT H. LEVITAS, Georgia
DAVID W. EVANS, Indiana
TOBY MOFFETT, Connecticut
HENRY A. WAXMAN, California
FLOYD J. FITHIAN, Indiana
TED WEISS, New York
MIKE SYNAR, Oklahoma
EUGENE V. ATKINSON, Pennsylvania
STEPHEN L. NEAL, North Carolina
DOUG BARNARD, JR., Georgia
PETER A. PEYSER, New York
BARNEY FRANK, Massachusetts
HAROLD WASHINGTON, Illinois
TOM LANTOS, California
BARBARA B. KENNELLY, Connecticut

FRANK HORTON, New York
JOHN N. ERLENBORN, Illinois
CLARENCE J. BROWN, Ohio
PAUL N. McCLOSKEY, JR., California
THOMAS N. KINDNESS, Ohio
ROBERT S. WALKER, Pennsylvania
M. CALDWELL BUTLER, Virginia
LYLE WILLIAMS, Ohio
JOEL DECKARD, Indiana
WILLIAM F. CLINGER, JR., Pennsylvania
RAYMOND J. McGRATH, New York
HAL DAUB, Nebraska
JOHN HILER, Indiana
WENDELL BAILEY, Missouri
LAWRENCE J. DeNARDIS, Connecticut
JUDD GREGG, New Hampshire
MICHAEL G. OXLEY, Ohio

WILLIAM M. JONES, *General Counsel*
JOHN E. MOORE, *Staff Administrator*
JOHN M. DUNCAN, *Minority Staff Director*

INTERGOVERNMENTAL RELATIONS AND HUMAN RESOURCES SUBCOMMITTEE

L. H. FOUNTAIN, North Carolina, *Chairman*

BARNEY FRANK, Massachusetts
ELLIOTT H. LEVITAS, Georgia
FLOYD J. FITHIAN, Indiana
STEPHEN L. NEAL, North Carolina

CLARENCE J. BROWN, Ohio
RAYMOND J. McGRATH, New York
LAWRENCE J. DeNARDIS, Connecticut

EX OFFICIO

JACK BROOKS, Texas

FRANK HORTON, New York

JAMES R. NAUGHTON, *Counsel*
DELPHIS, C. GOLDBERG, *Professional Staff Member*
CHRIS COOPER, *Professional Staff Member*
PAMELA H. WELSH, *Secretary*

LETTER OF TRANSMITTAL

HOUSE OF REPRESENTATIVES,
Washington, D.C., October 1, 1982.

Hon. THOMAS P. O'NEILL, Jr.,
Speaker of the House of Representatives,
Washington, D.C.

DEAR MR. SPEAKER: By direction of the Committee on Government Operations, I submit herewith the committee's thirty-eighth report to the 97th Congress. The committee's report is based on a study made by its Intergovernmental Relations and Human Resources Subcommittee.

JACK BROOKS, *Chairman.*

Blank Page

CONTENTS

	Page
I. Introduction	1
II. Findings and recommendations	2
Summary of findings	2
Recommendations	5
III. Background	6
Auditing standards	6
Weaknesses in grant-by-grant auditing	7
Attachment P to Circular A-102	12
IV. Subcommittee hearings	15
A. Is the single audit process conceptually sound and administratively feasible?	15
Conceptual soundness	15
Administrative feasibility	16
Need for increased cooperation	16
State and local government auditing capabilities	17
Quality review procedures	18
Participation of small and minority-owned public accounting firms	19
Cognizant Federal agencies	21
B. To what extent has attachment P to Circular A-102 been successfully implemented?	23
Extent of implementation	23
Definition of a single audit	24
Meeting Federal audit needs	26
Meeting State and local audit needs	28
Reimbursement for audit costs	29
C. Will implementation of the single audit result in cost savings to the Federal Government and to other governmental units involved?	33
D. Is legislation mandating the single audit process necessary or advantageous at this time?	34

VIEWS

Additional view of Hon. John N. Erlenborn, Hon. Frank Horton, Hon. Clarence J. Brown, Hon. Thomas N. Kindness, Hon. Robert S. Walker, Hon. Joel Deckard, Hon. William F. Clinger, Jr., Hon. Raymond J. McGrath, Hon. John Hiler, Hon. Judd Gregg, and Hon. Michael G. Oxley 38

97TH CONGRESS
2d Session

HOUSE OF REPRESENTATIVES

REPORT
No. 97-917

IMPROVING THE FINANCIAL MANAGEMENT AND AUDITING OF FEDERAL ASSISTANCE PROGRAMS: THE "SINGLE AUDIT" CONCEPT

OCTOBER 1, 1982.—Committed to the Committee of the Whole House on the State of the Union and ordered to be printed

---

Mr. BROOKS, from the Committee on Government Operations, submitted the following

THIRTY-EIGHTH REPORT

together with

ADDITIONAL VIEWS

On September 28, 1982, the Committee on Government Operations approved and adopted a report entitled "Improving the Financial Management and Auditing of Federal Assistance Programs: The 'Single Audit' Concept." The chairman was directed to transmit a copy to the Speaker of the House

I. INTRODUCTION

This report is based on a study by the Intergovernmental Relations and Human Resources Subcommittee on the efficiency and effectiveness of the auditing of Federal assistance to State and local governments. In its study, the subcommittee gave special attention to evaluating the "single audit" process prescribed by the Office of Management and Budget in Attachment P to Circular A-102, entitled "Uniform Requirements for Assistance to State and Local Governments."

The Federal Government relies on auditing as one of the principal means of insuring accountability in the use of Federal grants received by State and local governments. The importance of auditing as a management tool is underscored by the tremendous growth in the Federal grant-in-aid system over the past two decades—from approximately 132 programs costing $7 billion in 1960, to over 500 programs at a cost of nearly $95 billion in 1981. Yet, despite the critical role played by auditing, reports published over

99-303 O

the past several years by this committee, the General Accounting Office, the Joint Financial Management Improvement Program, and others have revealed serious flaws in the grant-by-grant approach which has traditionally been used to audit Federal grant programs. These studies have concluded that the auditing of individual grants is uncoordinated, inefficient and ineffective, and have recommended the adoption of a "single audit" approach. Attachment P to Circular A-102 was issued by OMB in October 1979 in an effort to implement the single audit through administrative regulations. Under the provisions of Attachment P, each State and local government and Indian Tribal government receiving Federal assistance is required to provide for a single organizationwide financial and compliance audit of its operations at least once every two years.

The single audit approach emphasizes evaluation of a grant recipient's internal financial control systems rather than detailed reviews of individual grants. It is intended to achieve more uniform audit coverage, as well as to place greater reliance on the independent audits performed by State and local auditors and public accounting firms. It is also intended to minimize the duplication of audits by Federal agencies and provide for a more efficient use of audit resources.

On March 31 and April 1, 1982, the subcommittee held hearings on H.R. 4133 and H.R. 4835, bills that would provide a statutory basis for the single audit process. These hearings were intended to address four basic issues:

Is the single audit process both conceptually sound and administratively feasible;

To what extent has Attachment P to Circular A-102 been successfully implemented;

Will implementation of the single audit result in cost savings to the Federal Government and to other governmental units involved; and

Is legislation mandating the single audit process necessary or advantageous at this time.

The hearings included testimony from Members of Congress; the Comptroller General of the United States; and Federal Inspectors General; as well as representatives of the Office of Management and Budget; the Municipal Finance Officers Association; the National Association of State Auditors, Comptrollers, and Treasurers; the National State Auditors Association; the American Institute of Certified Public Accountants; and the National Society of Public Accountants.

II. Findings and Recommendations

SUMMARY OF FINDINGS

1. In a 1979 report, the committee endorsed the single audit concept as a means of achieving more efficient and effective auditing of Federal assistance to State and local governments, and recommended that the Office of Management and Budget take specific actions to insure its implementation. After reviewing the implementation of Attachment P to Circular A-102, by which OMB has

prescribed the single audit requirements, the committee reaffirms its support for this very promising approach. However, the committee has found that while considerable progress has been made in developing the basic administrative procedures and guidance documents, relatively few single audits have actually been completed, and many problems currently hamper widespread adoption of this method. It is the committee's view that further experience with Attachment P is desirable before Congress enacts legislation for this purpose. The committee anticipates in this connection that the current work of the Office of Management and Budget and the General Accounting Office in monitoring and evaluating the implementation of Attachment P will provide valuable information for designing appropriate single audit legislation.

2. The single audit method has not been widely used. As of September 1981, only 59 single audits had been completed, and another 108 were underway. However, these figures may understate the actual number of single audits, since the committee has been informed that grant recipients sometimes initiate audits without notifying their Federal cognizant agencies.

3. A lack of consensus among Federal, State and local officials on the scope and coverage of a single audit is one of the major problems hampering implementation of Attachment P. In particular, there is disagreement concerning the compliance component of single audits, as State and local officials have complained that Federal agencies have required an excessive amount of compliance auditing.

4. Reliable data are not currently available on the potential cost impact of single audits on Federal, State and local governments. The committee believes it important to determine whether the broader coverage envisioned by the single audit will entail substantially greater costs for the participating governments, or whether the intended reduction of audit duplication and overlap will in fact produce significant offsetting savings.

5. State and local auditors have experienced difficulty in obtaining reimbursement for their expenses in auditing Federal grant programs. While it is intended that reimbursement be provided through the indirect cost allocation method prescribed by OMB Circular A-87, this arrangement apparently has not been effective because Federal, State and local program administrators are often reluctant to allow program funds to be used for indirect costs. Consequently, some organizations representing State and local officials have called for direct reimbursement of audit costs.

6. To facilitate audit reimbursement, several States and local governments have developed, or are developing, their own "set-aside" procedures designed to earmark grant funds for audit purposes. Similarly, the Office of Management and Budget has revised the cost allocation process prescribed by Circular A-87 to allow State governments the option of developing a separate indirect cost rate for audit expenses.

7. Some States and local officials have questioned the administrative feasibility of the present cognizant agency system, which relies on multiple Federal agencies to administer the single audit process. They have urged the Federal Government to consider establishing a single Federal grant auditing agency to replace the existing cog-

99-303 O - 82 - 2

nizant agency arrangement. In this connection, the Office of Management and Budget is presently implementing alternative cognizance arrangements intended to address the problems experienced by State and local governments in dealing with more than one cognizant agency. These new arrangements involve assigning either one agency or a "lead" agency to exercise cognizance over individual State and local governments.

8. Some single audit reports submitted to Federal cognizant agencies by grant recipients have not met Federal audit needs as prescribed by Attachment P to OMB Circular A-102 and supporting guidance documents. This problem is attributable primarily to the fact that all interested Federal agencies have not participated in the planning stages of the single audit. The committee believes that consultation among Federal agencies concerning their audit needs and Federal participation in grant recipients' preparations for single audits can help insure that audit reports satisfy Federal audit needs. In addition, these liaison and technical assistance activities should reduce both the amount of staff effort spent on revising audit reports and the need for followup audits by Federal auditors, thereby helping to achieve a more efficient use of audit resources for all governments involved.

9. State and local officials have complained that many of the single audits initiated to date have been designed primarily to satisfy Federal requirements. The committee believes the single audit can achieve its full potential as a management tool only if it meets the needs of all governments involved. However, State and local governments have the responsibility for insuring that their own audit needs are incorporated into single audit plans.

10. Attachment P to Circular A-102, and the guidelines issued by the Joint Financial Management Improvement Program, require Federal cognizant agencies to perform comprehensive "quality assessment reviews" of State audit organizations have undergone "peer reviews" conducted under the auspices of the intergovernmental audit forums or the National State Auditors Association, and the Treasury Department's Office of Revenue Sharing currently reviews the operations of many State audit organizations in connection with the audit requirements of the State and Local Fiscal Assistance Act of 1972, as amended (general revenue sharing program). The committee believes that utilization of these evaluations by cognizant agencies could help prevent unnecessary duplication of effort and provide for a more efficient review system.

11. Implementation of the single audit process could put small and minority-owned public accounting firms at a competitive disadvantage since small firms may lack sufficient resources to perform organization wide audits. While the Office of Management and Budget has revised Attachment P to help insure that such firms are afforded "maximum practicable opportunity" to participate in the single audit process, the National Association of Minority Certified Public Accounting Firms has called for mandatory set-asides.

12. Successful implementation of the single audit will require greater coordination and cooperation on the part of Federal, State and local officials, as well as members of the public accounting profession. The committee believes that such groups as the intergovernmental audit forums and the Single Audit Policy Conferences

under the sponsorship of the General Accounting Office can play an important role in promoting this coordination and cooperation.

RECOMMENDATIONS

OMB implementation of attachment P to circular A-102

1. The committee recommends that the Office of Management and Budget insure that Federal, State and local officials are provided with clear and consistent information on the requirements of Attachment P. In particular, OMB should assure that the single audit and the compliance supplement contain specific, unambiguous language concerning the scope and coverage of a single audit.

2. The committee recommends that the Office of Management and Budget establish suitable review procedures to assure, to the maximum extent feasible, the uniform interpretation and implementation of Attachment P by all Federal agencies.

3. The committee recommends that the Office of Management and Budget take appropriate action to insure that Federal cognizant agencies implement the liaison and technical assistance provisions of Attachment P and the guidelines for cognizant agencies issued by the Joint Financial Management Improvement Program.

Determining the cost impact of the single audit

4. The committee recommends that the Office of Management and Budget and the General Accounting Office develop more comprehensive information on the potential cost impact of the single audit on Federal, State and local governments.

Federal cognizant agency system

5. The committee recommends that the General Accounting Office evaluate the comparative advantage of assigning either one agency or a "lead" agency to exercise cognizance over individual State and local governments.

6. The committee recommends that the General Accounting Office evaluate the feasibility and desirability of establishing a single Federal agency to administer the single audit process.

Reimbursement

7. The committee recommends that the Office of Management and Budget revise Circular A-87 to allow local governments, as well as State governments, the option of developing a separate indirect cost rate for audit expenses.

8. Except where indirect costs are limited by statute, the committee recommends that Federal agencies reimburse audit costs in accordance with the provisions of OMB Circular A-87 and the cost allocation guidelines issued by the Department of Health and Human services.

Quality review procedures

9. The committee recommends that when a State or local audit organizations has undergone a peer review performed in accordance with the guidelines developed by the National Intergovernmental Audit Forum and the State Auditor Coordinating Commit-

tee, all Federal cognizant agencies accept the review in lieu of performing their own quality assessment review.

10. The committee recommends that Federal cognizant agencies utilize the evaluations of State audit organizations performed by the Treasury Department's Office of Revenue Sharing to the maximum extent possible when conducting quality assessment reviews.

Participation of small and minority-owned accounting firms

11. The committee recommends that the Office of Management and Budget evaluate the adequacy of Paragraph 16 in Attachment P for assuring the participation of small and minority-owned accounting firms in the single audit process.

III. Background

AUDITING STANDARDS

The Federal Government's auditing standards are specified by the General Accounting Office's "Standards for Audit of Governmental Organizations, Programs, Activities and Functions," generally known as the "yellow book." First adopted in 1972, and revised in 1974 and 1981, these standards "relate to the scope and quality of audit effort and to the characteristics of professional and meaningful audit reports." [1] The Inspector General Act of 1978 requires Federal Inspectors General to comply with GAO's standards, and to assure that non-Federal auditors involved in auditing Federal funds conform to them as well.[2] In addition, Attachment P to Circular A-102 specifies that State and local governments receiving Federal assistance shall be audited in accordance with these standards.

The American Institute of Certified Public Accountants has adopted standards and procedures applicable to audits of an organization's financial statements, and GAO has incorporated these standards into the "yellow book." However, the Comptroller General has determined that "the interests of many users of reports on government audits are broader than those that can be satisfied by financial audits." [3] Thus, in addition to the AICPA standards, GAO has adopted standards providing for "expanded scope" auditing of government programs.

The three elements of expanded scope auditing are:[4]

1. *Financial and compliance.*—Determines (a) whether the financial statements of an audited entity present fairly the financial position and the results of financial operations in accordance with generally accepted accounting principles and (b) whether the entity has complied with laws and regulations that may have a material effect upon the financial statements.

2. *Economy and efficiency.*—Determines (a) whether the entity is managing and utilizing its resources (such as per-

[1] U.S. General Accounting Office, "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," 1981 Revision, page 1.
[2] P.L. 95-452, Section 4(b)(3), October 12, 1978.
[3] U.S. General Accounting Office, "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," 1981 Revision, page 1.
[4] Ibid., page 3.

sonnel, property, space) economically and efficiently, (b) the causes of inefficiencies or uneconomical practices, and (c) whether the entity has complied with laws and regulations concerning matters of economy and efficiency.

3. *Program results.*—Determines (a) whether the desired results or benefits established by the legislature or other authorizing body are being achieved and (b) whether the agency has considered alternatives that might yield desired results at a lower cost.

The GAO standards note that while an audit of a governmental entity may include all three elements described abvove: [5]

> * * * It is not intended or even feasible or desirable that every audit include all three. The expanded scope audit should not be conducted routinely, but instead selected when it will meet the needs of expected users of the audit results.

Attachment P to Circular A-102 requires only the financial and compliance component of an expanded scope audit.

In addition to defining the elements of governmental auditing, the "yellow book" prescribes standards on a number of related issues, including field work and reporting requirements, the professional qualifications of auditors, and auditor "independence." It also calls for utilization of the single audit approach: [6]

> An assumption underlying all the standards is that governments will cooperate in making audits in which they have mutual interests. This is especially true when one government receives funds from several others and each has a continuing need for a basic financial and compliance audit. In these circumstances, audits should be made on an organizationwide basis whenever possible, rather than on a grant-by-grant basis, and in a manner that will satisfy the audit needs of the participating governments.

WEAKNESSES IN GRANT-BY-GRANT AUDITING

Federal grants to State and local governments have traditionally been audited on a grant-by-grant basis. However, numerous studies conducted over the past several years have sharply criticized this approach to auditing as uncoordinated, inefficient, and ineffective in insuring accountability in the use of Federal funds. The findings and recommendations of three of these studies, issued in 1979 by the Joint Financial Management Improvement Program (JFMIP), the General Accounting Office (GAO), and this committee, are discussed briefly here.

In January 1977, the four agencies which sponsor the JFMIP—GAO, OMB, the Treasury Department, and the Office of Personnel Management—established an *ad hoc* Audit Improvement Project to address the problems surrounding the auditing of Federal grants to State and local governments. In February 1979, the JFMIP issued

[5] Ibid., page 3.
[6] Ibid., page 5.

its "Report on Audit of Federally Assisted Programs: A New Emphasis," which found: [7]

> Our study corroborates the findings of previous studies by other organizations that considerable duplication and overlap of effort exist in auditing federally assisted programs and that there are substantial gaps in audit coverage. Also there is limited coordination of audits between Federal auditors or with State and local auditors and public accountants hired by recipients.
>
> Duplication and overlap of audit effort are most prevalent at the local government level. Duplication and overlap occur when different audit organizations audit an entity within the same period and review the same accounting records, internal controls, and policies; contact the same personnel; and audit the same organizational segments of an entity. They also occur when an audit of a grant is made and the audit is subsequently determined as inadequate, causing the auditors to reaudit the same grant covering essentially the same areas.
>
> Gaps in audit coverage exist at all levels. Gaps occur primarily from the failure of auditors to assess compliance with grant requirements, but also from infrequent audits of certain Federal programs. * * *

In examining the causes of audit gaps, duplication and overlap, the report noted that under the grant-by-grant approach there is limited coordination between Federal auditors, as each Federal agency typically audits its own grants "with little or no concern for the grant funds of other Federal agencies, requiring separate audits by each." [8] And, while non-Federal auditors often audit Federal grant funds, they generally perform only financial audits that do not include a review of a grantee's compliance with grant requirements. Since Federal agencies are primarily concerned with compliance testing, these narrowly-focused financial audits do not satisfy Federal requirements. This uncoordinated approach results in either substantial gaps in compliance audit coverage or the need for additional audits by Federal auditors.

The report concluded: [9]

> * * * Continuation of the practice whereby each auditor audits primarily to satisfy his own organization's needs would confound audit coordination and perpetuate duplication and overlap and gaps in coverage. Further, it would effectively preclude the optimum use of audit resources.
>
> We believe the answer lies in Federal agencies adopting the single audit approach to auditing federally assisted programs. This would provide for a single financial and compliance audit of a recipient covering all the recipient's funds. The audit would be regularly conducted on an organizationwide basis to assess the fiscal integrity of finan-

---

[7] Joint Financial Management Improvement Program, "Report on Audit of Federally Assisted Programs: A New Emphasis," February 1979, page 1.
[8] Ibid., page 18.
[9] Ibid., page 1.

> cial transactions and to assess compliance with grant requirements. The latter would involve, for example, checking whether eligibility requirements had been met, grant funds had been spent for the intended service or product, cost allocations had been proper, direct charges had been reasonable, and any matching requirements had been met. * * *

While urging adoption of the single audit process, the JFMIP report noted that this approach is not new, as it "has been the intent of OMB circulars since at least 1974" to have audits of Federal grant recipients conducted on an organizationwide basis, rather than a grant-by-grant basis. However, the report concluded that Federal agencies and grant recipients were generally not performing single audits and that OMB needed to "clarify the single audit requirement" and establish specific procedures and guidelines to facilitiate implementation of the process.[10]

The report's principal recommendations were that:

A single uniform Federal audit guide be developed to replace the approximately 80 individual program audit guides in use by Federal agencies;

Conflicting statutory and administrative audit requirements by eliminated;

Improved procedures be developed for reimbursing non-Federal auditors for the Federal Government's share of the cost of auditing grant recipients;

An information system be developed for tracking the flow of Federal funds to grant recipients;

A system of "cognizant" Federal agencies be established to facilitate coordination of the audits of grant recipients; and

A study be conducted to determine the feasibility of establishing a single Federal agency to be responsible for monitoring the auditing of Federal grant programs.

The findings and recommendations of the General Accounting Office's June 1979 report, "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling," were very similar to those of the JFMIP report. The report concluded: [11]

> * * * Important as grant auditing is, GAO found that Federal agencies' approaches to it are not coordinated and do not provide effective surveillance of these public funds or optimize the use of audit resources.
>
> The ideal in auditing grant programs is to have a single audit of a recipient that would be acceptable to all the funding organizations. This audit should assure that the recipient's financial records and controls are adequate and check for compliance with important terms of the grants received. Such audits would be made periodically when needed. Funding organizations would then be free to per-

[10] Ibid., pages 34–40.

[11] United States General Accounting Office, "Grant Auditing: A Maze of Inconsistency, Gaps, and Duplication That Needs Overhauling," FGMSD–79–37, June 15, 1979, page i.

> form additional audits of economy and efficiency and program results as deemed necessary.
>
> This ideal is far from being achieved. In general, agencies audit only their own grants. They do not completely review grant recipients' financial controls and pay little attention to how a recipient's grant management practices affect other Federal grants, even those of much larger amounts. Under this narrow approach, the auditors are unlikely to detect improper charges or transfers of funds and equipment to the grant. Moreover, Federal agencies do not provide for audits of many grants while providing for repeated audits of other grants with minimal results.
>
> This disorganized approach to grant auditing costs time and money. The Government can lose millions of dollars through gaps in audit coverage. Unnecessary costs result from duplication of effort and from performing audits too often of grants too small to warrant more than an occasional audit. Also, numerous audits unnecessarily disrupt the grantee's staff. * * *

The report presented the findings of a field review of 73 grant recipients which revealed serious deficiencies in audit coverage and clearly illustrated the ineffectiveness of the grant-by-grant approach. Over a four-year period, 80 percent of the recipients' Federal funds were either not audited at all or received audits that did not provide Federal officials with sufficient information to determine whether the grant monies were properly spent. According to the report, many of the inadequate audits were performed by non-Federal auditors to satisfy only State and local requirements.[12]

Like the JFMIP report, the GAO study recommended the development of a uniform audit guide, the designation of Federal cognizant agencies, the elimination of conflicting audit requirements, and the establishment of a system to identify Federal grants received by recipients. However, GAO did not recommend that the feasibility of a single Federal auditing agency be explored, nor did the report call for procedures facilitating reimbursement of non-Federal auditors. However, with respect to reimbursement, GAO recommended that the Federal Government stipulate that in order to receive any reimbursement at all, non-Federal auditors must follow Federal audit guidelines when auditing grant recipients.

In November 1979, this committee issued a report entitled, "Failure To Provide Effective Audits of Federal Grants," which concluded that "Auditing of Federal grants is haphazard and ineffective." [13] The report was based on hearings conducted by the Legislation and National Security Subcommittee and the GAO study discussed above. Noting that the Office of Management and Budget "has not taken a strong enough role in establishing the mechanisms and structure" needed to improve grant auditing procedures, the committee recommended: [14]

---

[12] Ibid., page 11.
[13] House Report No. 96-580, 96th Congress, 1st Session, November 1, 1979, "Failure to Provide Effective Audits of Federal Grants," page 3.
[14] Ibid., page 4.

1. The Director of the Office of Management and Budget should establish policy guidance and mechanisms to implement single, coordinated financial and compliance audits of grant recipients on a government-wide basis. These should, as a minimum, include the following:

"(a) Written policies for Federal agencies, state and local governments, and nonprofit grant recipients, which provide consistent and coordinated guidance to insure that the audits are made when needed and are uniformly instituted.

"(b) A logical system to designate Federal agencies for audit cognizance over selected governmental and nonprofit organizations receiving Federal assistance. Such designations should be reassessed periodically, at least once every three years. Each agency would be responsible for insuring appropriate financial and compliance audit coverage of the recipients under its cognizance.

"(c) A standard guide for auditing multifunded grant recipients, including carefully worked out compliance tests acceptable to grant-making agencies.

"(d) A requirement that non-Federal audits must follow Federal audit guidelines as one of the conditions for payment of Federal funds.

"(e) A centralized information system on multifunded grant recipients, covering both governmental and nonprofit organizations, that identifies who they are and what Federal funds they receive."

2. The Director of the Office of Management and Budget should require each agency to establish a system for maximizing the use of non-Federal audits of the grant recipients under its cognizance. The system should provide for:

"a means of knowing when audits required under OMB Circulars A-102 and A-110 [entitled, "Uniform Administrative Requirements for Grants and Other Agreements With Universities, Hospitals, and Other Nonprofit Organizations"] are made or should be scheduled;

"controls to insure that the required audits comply with the single audit and other acceptable Federal audit requirements;

"procedures to evaluate non-Federal audit work and to insure that the grant recipient is properly audited; and

"a liaison with non-Federal audit staffs to minimize the amount of audit work required."

3. The Director of the Office of Management and Budget should provide for prompt implementation of the single audit concept by working closely with the Federal agencies and by augmenting its staff with agency staff to accomplish the task.

4. The Director of the Office of Management and Budget should determine whether there is adequate staff within the Federal audit organizations, including those of the Inspector General Offices, to carry out the new single audit approach without reducing other essential work. He should advise the Committee on Government Operations of

99-303 O - 82 - 3

the Inspector General staffing needs for each agency no later than March 31, 1980.

5. The Director of the Office of Management and Budget should take steps to remove the inconsistencies in Federal laws and regulations that hinder audit coordination. He should advise the appropriate Committees in Congress of changes needed in existing laws no later than March 31, 1980.

ATTACHMENT P TO CIRCULAR A-102

Issued by the Office of Management and Budget in October 1979 in response to these studies, Attachment P to Circular A-102 requires each State and local government and Indian Tribal government receiving Federal assistance to provide for a single organizationwide financial and compliance audit of its operations, "usually * * * annually, but not less frequently than every two years.[15] Grantees are expected to arrange for these audits and to prescribe their scope; however, the audits must comply with the standards and requirements set forth in the Attachment. Federal agencies are not prohibited from conducting their own audits of grantees, "However, if independent audits arranged for by recipients meet the requirements prescribed * * * all Federal agencies shall rely on them, and any additional audit work shall build upon the work already done."[16]

Attachment P specifies that audits of grant recipients be made in accordance with GAO's "Standards for Audit of Governmental Organizations, Programs, Activities, and Functions," as well as "Guidelines for Financial and Compliance Audits of Federally Assisted Programs," issued jointly by OMB and GAO, and "any compliance supplements approved by OMB, and generally accepted auditing standards established by the American Institute of Certified Public Accountants."[17]

While Attachment P calls for audits on an organizationwide basis, it does not specify what comprises the "organization" or "entity" to be audited. However, OMB has subsequently advised Federal, State and local officials:[18]

> The organization should be the organization for which the government [being audited] traditionally prepares financial statements (including grant financial statements) and obtains an audit. It may be the entire state or city or a department or other entity within a state or city. The decision on what constitutes the organization should be made by State or local government officials, not by the Federal Government.

The "Guidelines for Financial and Compliance Audits of Federally Assisted Programs" represents a governmentwide audit guide intended to replace the approximately 80 individual program audit guides previously in use by Federal agencies. First issued by GAO

---

[15] OMB Circular A-102 (Revised) Attachment P, Paragraph 8, January 1981.
[16] Ibid., Paragraph 4
[17] Ibid., Paragraph 5.
[18] Hearings, page 107.

in October 1978, the guide was subsequently revised and reissued jointly by GAO and OMB in April 1980. It is currently being revised by the American Institute of Certified Public Accountants in conjunction with members of the governmental audit community, and is expected to be reissued later this year. As noted earlier, the Joint Financial Management Improvement Program, the General Accounting Office, and this committee have recommended the development and use of a standard audit guide for Federal grant programs.

To facilitate the compliance component of single audits, OMB, in August 1980, issued a supplement to Attachment P listing the major compliance requirements of 60 Federal grant programs, representing approximately 90 percent of total Federal aid to State and local government. The supplement is currently being revised and updated to reflect recent changes in the Federal grant system, including the new block grants established by the Reconciliation Act of 1981.[19]

Attachment P prescribes a cognizant agency system for the single audit process, as recommended by this committee, the GAO, and the JFMIP. The role of the cognizant agency includes acting as a liaison between Federal agencies, independent auditors and grant recipients; making or obtaining quality assessment reviews of non-Federal audit organizations; reviewing audit reports and disseminating them to other Federal agencies; providing technical assistance to auditors and recipients; and assuring resolution of audit findings. These activities are the responsibility of the Office of Inspector General within the various Federal agencies. In October 1981, the JFMIP issued "Cognizant Audit Agency Guidelines Under OMB Circular A-102 Attachment P." Developed by the Federal Inspectors General under the sponsorship of the JFMIP, the guidelines are intended to establish uniform procedures for Federal cognizant agencies.

In October 1980, OMB issued a supplement to Attachment P assigning cognizant agencies to nearly 800 State departments and agencies considered to be "major" recipients of Federal aid. Cognizance responsibilities were generally assigned to the Federal agency providing the largest share of Federal assistance to a particular State department or agency. While this procedure originally resulted in each State being assigned multiple cognizant agencies, OMB noted: [20]

> A few States indicated a preference for one cognizant agency for the entire State, rather than one for each major department or agency. Because of uncertainty as to how this arrangement would work, it was decided to test the concept in one State, Montana, before passing judgement on its feasibility elsewhere. After an evaluation of the Montana experience, additional State-wide assignments may be considered.

In March 1982, the 300 largest general purpose local governments were assigned Federal cognizant agencies. The cognizance

---

[19] Public Law 97-35, August 13, 1981

[20] Federal Register, Vol. 45, No. 195, October 6, 1980, page 66338.

assignments were made by OMB in cooperation with the International City Management Association (ICMA). ICMA surveyed the 300 governments to obtain information concerning how Federal grants are accounted for and administered within each jurisdiction. Based upon the information received, ICMA recommended cognizant agency assignments that were subsequently agreed to by OMB and the Federal Inspectors General. Some local governments were assigned one cognizant agency, while others were assigned several. However, whenever multiple assignments were made, OMB designated one of the Federal agencies to serve as "lead cognizant audit agency." The lead agency is responsible for acting as a single Federal contact in those instances in which a local government elects to define the "organization" to be audited as the entire governmental unit, rather than individual departments or agencies.

Cities, towns and counties not among the 300 largest general purpose local governments, but with populations in excess of 50,000, were assigned to the Federal department or agency responsible for approving their indirect cost rates under the provisions of OMB Circular A-87 ("Cost Principles for Grants and Contracts With State, Local, and Federally Recognized Indian Tribal Governments"). General purpose local governments with populations of less than 50,000 were assigned to the Federal agency providing the largest share of their grant funds. School districts in Arkansas, Georgia, Maryland, Minnesota, Oregon, Utah and Puerto Rico were assigned to the Department of Agriculture, while those in all other States were assigned to the Department of Education. Indian Tribal governments and territorial governments were assigned to the Department of the Interior. Special purpose districts were assigned as follows: Housing agencies to the Department of Housing and Urban Development; transit, port, and airport authorities to the Department of Transportation; planning and development districts to the Department of Commerce; sewer and water districts to the Environmental Protection Agency; and all others to the agency providing the largest share of grant funds.

In December 1981, OMB issued "Questions and Answers on the Single Audit Provisions of OMB Circular A-102 'Uniform Requirement for Grants to State and Local Governments,' " a booklet intended to provide additional single audit policy guidance to Federal, State and local government officials. The booklet contains answers to questions that have been frequently raised with respect to Attachment P.

OMB is currently developing the Federal Assistance Awards Data System (FAADS) which will provide information on the flow of Federal funds to individual units of State and local governments. As noted earlier, the development of such a system to facilitate the auditing of Federal grant recipients was recommended by this committee, by the General Accounting Office, and by the Joint Financial Managment Improvement program.

IV. Subcommittee Hearings

A. Is the single audit process conceptually sound and administratively feasible?

Conceptual soundness

In testimony before the subcommittee, Charles Bowsher, Comptroller General of the United States, expressed strong support for the single audit process. Mr. Bowsher stated:[21]

> I would like to say at the outset that I view the concept of a single audit on an entity basis to be superior to the more common practice of auditing on a grant-by-grant basis. This concept, as it is currently administered by the Office of Management and Budget, is still in the early development stages and poses a number of problems that need to be resolved.
>
> However, if we can address these problems and get the concept accepted and implemented by the entire audit community, it will go a long way toward closing the gap in grant audit coverage that we have been complaining about over the years. This improvement will be brought about by an approach that emphasizes a review of the internal controls of the entity being audited rather than a detailed audit of each grant.
>
> Achieving adequate coverage through detailed grant-by-grant audits would be very difficult and extremely costly. The advantage of the single audit approach is that it provides an improved audit base for performing additional selective audits to satisfiy specific Federal, state and local user needs such as those concerning detailed compliance issues, and economy and efficiency or program results.

Other witnesses testified that the single audit approach will not only close existing gaps in audit coverage, but will also greatly reduce the duplication and overlap associate with auditing on a grant-by-grant basis. They noted that this should result in a far more efficient use of audit resources and less disruption of the organization being audited. However, like the Comptroller General, these witnesses indicated that many problems currently hamper widespread adoption of this method.

While voicing support of the single audit concept, many witnesses stressed that it is very important for Federal, State and local officials to maintain realistic expectations as to what this approach is capable of accomplishing. They indicated that the single audit can provide an evaluation of a grant recipient's internal control systems, as well as a review of the grantee's compliance with major grant requirements, but that it will not provide detailed compliance auditing of individual grants. However, while individual grants will be reviewed in less depth than under the grant-by-grant approach, the breadth of coverage for Federal funds will be much greater. According to James Thomas, Inspector General of the Department of Education, this expanded breadth of coverage

---

[21] Hearings, page 29.

will provide "broad assurances, never possible before, on whether the recipients' or subrecipients' systems are adequate to assure proper accountability. Federal auditors can still do additional audit work which builds on the work already performed." [22]

The committee believes the single audit process is conceptually sound. While the single audit will provide less detailed coverage of individual Federal grants, this approach has the potential to substantially reduce the gaps, duplication and overlap that have characterized the traditional grant-by-grant auditing of State and local governments receiving Federal assistance. At the same time, however, many issues remain to be resolved before the single audit can be successfully implemented. Several of these issues will be discussed in the remainder of this report.

Administrative feasibility

Need for increased cooperation

While testifying that the single audit process is conceptually sound, Comptroller General Bowsher also stated:[23]

> The evolutionary development of single audit policy and its implementation is particularly complex because it requires the cooperation and participation of many organizations both private and public.

The committee concurs with Mr. Bowsher's assessment, but it is optimistic that the single audit can be successfully implemented with the help of such groups as the intergovernmental audit forums and the Single Audit Policy Conferences under the sponsorship of the General Accounting Office.

Established during the mid-1970's under the guidance of the General Accounting Office, the intergovernmental audit forums are intended to foster coordination and cooperation among Federal, State and local governmental audit officials, as well as members of the public accounting profession. There are currently ten regional forums and one national forum. Membership is voluntary and includes officials from GAO, OMB, the various Federal Offices of Inspector General, State and local auditors and finance officers, as well as representatives of professional audit associations and public accounting firms. The individual forums meet several times a year, and once every two years a joint conference of all the forums is held. The forums operate on an informal basis, and their decisions are not binding on members. While the forums deal with a wide variety of auditing issues, the committee understands that over the past few years they have devoted considerable effort to assisting in the development and implementation of the single audit process.

In testimony before the subcommittee, the Comptroller General expressed his intention to establish an advisory committee to facilitate implementation of the single audit process. Mr. Bowsher stated:[24]

---

[22] Hearings, page 162.
[23] Hearings, page 31.
[24] Hearings, page 33.

> * * * There is a real need for leadership to come to grips with the issues which have been holding up effective implementation.
>
> I plan to create an audit policy advisory committee which includes representatives from both the public and private sector audit and user communities such as OMB, the Inspectors General, State Auditor Coordinating Committee, AICPA, and the MFOA, and users from all levels of government.
>
> This committee, working together, can provide the focus needed to address problems as they arise and advise me on how to make the single audit concept an effective tool for oversight.

The committee understands that the Comptroller General has scheduled a series of "Single Audit Policy Conferences" to achieve the goals outlined in his testimony. Representatives of the various groups mentioned by Mr. Bowsher will be invited to attend these conferences.

In late 1980, the Joint Financial Management Improvement Program established a Single Audit Steering Committee intended to "look into implementation problems of the single audit approach, to make recommendations to resolve them and to provide general assistance in the implementation of the single audit approach." [25] The Steering Committee met about ten times before being dissolved in August 1982. The membership of the committee included Federal, State and local governmental audit officials as well as representatives of the American Institute of Certified Public Accountants. Special task forces were established to study and make recommendations on various issues identified as problem areas in implementation of the single audit. Among the issues studied were auditor reimbursement, uniform criteria for single audits, and the participation of small and minority-owned public accounting firms in the single audit process.

State and local government auditing capabilities

One of the principal goals of the single audit process is to place greater reliance on the independent audits performed by State and local auditors and public accounting firms. It is, therefore, essential that State and local governments have access to adequate resources to perform the role prescribed for them by Attachment P. While some State and local governments have indicated that they currently do not have the audit staffs necessary to comply with Attachment P, Comptroller General Bowsher testified: [26]

> I feel very strongly that there is plenty of auditing capability in this country to do the audits that are mandated or would be mandated by legislation. It is very much up to the States, cities, and counties as to whether they want to build their own independent auditing capability or employ the services of professional firms in the private sector. Some years back there was a general impression that the

[25] Minutes of the Single Audit Steering Committee meeting, November 13, 1980.
[26] Hearings, page 36.

country didn't have the auditing capability to do this kind of work. I thik that is just not true. I think there is plenty of capability out there today.

Quality review procedures

As noted earlier, in October 1981 the Joint Financial Management Improvement Program issued "Cognizant Audit Agency Guidelines Under OMB Circular A-102 Attachment P," a document intended to establish uniform procedures for Federal cognizant agencies. The guidelines state that in order to insure that single audits meet Federal requirements, cognizant agencies should provide technical assistance to grant recipients and their auditors, and perform "desk reviews" of all audit reports. (The issue of meeting Federal audit requirements is discussed in greater detail later in this report.) In additon, Attachment P requires cognizant agencies to evaluate the quality of the work supporting the reports:[27]

> The cognizant agency shall * * * obtain or make quality assessment reviews of the work of non-Federal audit organizations, and provide the results to other interested audit agencies. (If a non-Federal audit organization is responsible for audits of recipients that have different cognizant audit agencies, a single quality assessment review should be arranged.)

The cognizant agency guidelines describe two types of quality review procedures: "quality control reviews" and "quality assessment reviews.' A quality control review (QCR) is an evaluation of the work pertaining to an individual audit or audits conducted by a State or local audit organization or an independent public accounting firm. The review is generally found on the working papers supporting an audit report(s). A quality assessment review (QAR) is a much more extensive evaluation:[28]

> A QAR is a comprehensive review of the governmental audit organization and its work. A QAR is made for the purpose of assessing whether the audit organization meets applicable professional standards pertaining to qualifications and independence and conducts its work with due professional care in accordance with professional standards, including standards for examination, evaluation and reporting.

The National Intergovernmental Audit Forum (NIAF) and the State Auditor Coordinating Committee (SACC) have jointly developed guidelines for performing quality reviews of governmental audit organizations, and the cognizant agency guidance document calls on cognization agencies to use these guidelines when conducting quality assessment reviews. However, the committee has learned that some State audit organizations have undergone voluntary "peer reviews" performed in accordance with the NIAF-SACC guidelines. Some of these reviews have been sponsored by the intergovernmental audit forums, while others have been sponsored by

---

[27] OMB Circular A-102 (Revised) Attachment P, Paragraph 14, January 1981.

[28] Joint Financial Management Improvement Program, "Cognizant Audit Agency Guidelines Under OMB Circular A-102 Attachment P," October 1981, page 7.

the National State Auditors Association. The committee believes that reliance on these peer reviews by cognizant agencies could help prevent unnecessary duplication of effort and provide for a more efficient quality assessment review system. The committee therefore recommends that when a peer review has been conducted in accordance with the NIAF-SACC guidelines, cognizant agencies accept the review in lieu of performing their own quality assessment review.

The Treasury Department's Office of Revenue Sharing (ORS) currently reviews the operations of many State audit organizations in connection with the audit requirements of the State and Local Fiscal Assistance Act of 1972, as amended (general revenue sharing program). State governments are not presently receiving revenue sharing payments and are therefore not required to submit audits to the ORS. Nevertheless, many State auditors are involved in local governments' revenue sharing audits. In some States, the State auditor is responsible for auditing local governments. In others, the auditor, through informal agreements with the ORS, reviews audits submitted by local governments to determine whether they meet Federal requirements.

While the ORS of State audit organizations are generally not as detailed as an evaluation performed in accordance with the NIAF-SACC guidelines would be, the committee believes they could serve as the basis for a more extensive quality assessment review. The committee therefore recommends that cognizant agencies utilize evaluations performed by the Office of Revenue Sharing to the fullest extent possible when conducting quality assessment reviews.

While the quality assessment review process prescribed by the cognizant agency guidelines is directed exclusively at governmental audit organizations, the important role of independent public accounting firms in the single audit process makes it essential that these firms perform quality audits as well. In this connection, the committee notes that the American Institute of Certified Public Accounts (AICPA) has instituted a mandatory peer review process for firms belonging to its Division of CPA firms. The AICPA requirements currently call for member firms to undergo such reviews once every three years. In addition, the Office of Revenue Sharing has conducted reviews of over 200 independent public accounting firms in connection with the audit requirements of the revenue sharing program. Finally, in testimony before the subcommittee, the Comptroller General noted that GAO and the AICPA cosponsored a conference in November 1980 to address the issue of substandard audits performed by CPA's. Mr. Bowsher indicated that the organizations are continuing their cooperative efforts to resolve this problem.

Participation of small and minority-owned public accounting firms

Many small and minority-owned accounting firms have been actively involved in auditing individual Federal grants to State and local governments. However, some of these firms have expressed concern that they will be adversely affected by the transition to the single audit method because they lack sufficient resources to per-

form organizationwide audits. In their opinion, this will put them at a disadvantage in competing with large accounting firms.

In response to this concern, OMB revised Attachment P in September 1980 to help insure that small and minority-owned accounting firms are afforded the "maximum practicable opportunity" to participate in the single audit process. While not mandating specific set-asides, the new provisions state that grantees shall use such firms to the "fullest extent practicable." To achieve this goal, the provisions encourage grantees to award audit contracts to consortiums of small and minority-owned firms, to assure that such firms are given consideration for audit subcontracting opportunities, and to "use the services and assistance, as appropriate, of the Small Business Administration [and] the Minority Business Development Agency of the Department of Commerce . . . in the solicitation and utilization of small or disadvantaged audit firms." [29]

To clarify the obligation of grant recipients under the new provisions (Paragraph 16) of Attachment P, OMB has subsequently advised Federal, State and local officials that while grantees must provide the "maximum practicable opportunity" for small and minority-owned firms to be considered for audit contracts: [30]

> * * * State and local governments and other recipients of Federal funds retain the authority to select audit firms at their discretion. Federal cognizant agencies do not have the authority under Paragraph 16 to challenge an audited organization's choice of audit firms. Paragraph 16 establishes a requirement of a fair and open process for selection of audit firms; it does not establish any requirement that particular firms or classes of firms be selected.

However, in a resolution adopted in August 1981, the National Association of Minority Certified Public Accounting Firms urged OMB and GAO to adopt stronger measures to insure the participation of small and minority-owned accounting firms. Included in the resolution was a recommendation that: [31]

> Federal regulations be amended to assure that small and minority CPA firms perform, at a minimum, twenty-five percent of the audits necessitated under the single audit approach.

In testimony before the subcommittee, Harold Steinberg, OMB Associate Director for Management, expressed doubts as to the appropriateness of mandatory set-asides for small and minority-owned accounting firms. He also stated that, in his opinion, these firms have had the opportunity to participate in the single audit process, though he acknowledged that his office currently does not have reliable information concerning the extent of their participation.

The committee supports the goal of insuring that small and minority accounting firms are afforded the maximum practicable opportunity to participate in the single audit process, and it is sensitive to the concern that the organizationwide approach could put

---

[29] OMB Circular A-102 (Revised) Attachment P, Paragraph 16, January 1981.
[30] Hearings, page 123.
[31] Hearings, page 217.

these firms at a competitive disadvantage. The committee therefore recommends that OMB evaluate the adequacy of Paragraph 16 in Attachment P for assuring the participation of small and minority-owned firms.

Cognizant Federal agencies

In testimony before the subcommittee, Val Oveson, State Auditor of Utah, and Patrick Glisson, Director of Finance for De Kalb County, Georgia, questioned the administrative feasibility of the current cognizant agency system. They maintained that with several Federal agencies responsible for administering the single audit process, Attachment P is subject to varying, and sometimes conflicting, interpretations. They also charged that OMB has been either unable or unwilling to provide the strong leadership needed to resolve the problems currently hampering implementation of the single audit. Mr. Oveson and Mr. Glisson strongly urged that the establishment of a single Federal grant auditing agency be given careful consideration, as recommended by the Joint Financial Management Improvement Program.[32] In their opinion, such an agency would help insure consistent interpretation of Attachment P, and provide more effective leadership for the single audit process.

Comptroller General Bowsher also indicated that there has been a lack of consistency among cognizant agencies with respect to implementation of the single audit.[33] He, too, expressed interest in a single Federal grant auditing agency: [34]

> * * * One of the areas I am also concerned with in this issue deals with different cognizant Federal agencies being named to watch over or interface with the State and local governments. We ought to examine whether a single cognizant agency of the Federal Government—it might be the revenue sharing group at Treasury—could monitor all of the auditing and be the focal point between the Federal Government and State and local governments on the single audit concept.

Other witnesses were less supportive of a single Federal grant auditing agency, as reflected by the following exchange between subcommittee Chairman Fountain and Harold Steinberg, OMB Associate Director for Management: [35]

> Mr. FOUNTAIN. The Comptroller General suggested yesterday that perhaps a single agency should be assigned responsibility for acting as the Federal representative in the single audit process. This one agency would replace the current cognizant agency arrangement.
>
> Mr. Bowsher suggested that the Office of Revenue Sharing in the Treasury Department might be an appropriate candidate for this role due to its experience in monitoring

[32] See footnote 7.
[33] Hearings, page 40.
[34] Hearings, page 37.
[35] Hearings, page 141.

the audits required in the general revenue sharing program.

What is your opinion as to whether or not a single agency of this kind would be practical and desirable?

Mr. STEINBERG. I am not so sure that the Inspectors General, whose offices were created under the auspices of this committee, would not be a more effective organization to provide the cognizance. If you put together a single audit agency, it would not be as familiar with the programs of the agencies that are being audited. That would come back to bite us, I think, in the audit follow-up process. The auditors or the Inspectors General have to work with the program people to make a decision as to which of the audit findings need to be sustained and result in recoveries to the Government.

Second, it would be another agency with attendant costs.

Third, you mentioned revenue sharing. The last time I looked, the revenue sharing audit capacity was rather limited. It did not have the field staff that our present Inspectors General have throughout the country in 10 regions of the Federal Government. Yet, it would not be able to do it out of Washington.

Mr. FOUNTAIN. If it were done by a single agency—I realize you are speculating now—where in the Federal Government could this responsibility be best administered?

Mr. STEINBERG. I am not quite sure.

Mr. FOUNTAIN. You still have the problem of an agency having to become familiar with the details of the various grant programs.

Mr. STEINBERG. There is another aspect, too. To be a good cognizant agency and follow up on what other auditors do, you have to get involved in auditing yourself now and then. If I had an agency that did nothing but cognizance—in other words, all they do is followup—it would never be involved in direct auditing. Also, I don't know where to place them. I don't think it is that sound an approach.

James Thomas and Joseph Welsch, Inspectors General of the Department of Education and the Department of Transportation, respectively, also expressed doubts as to the desirability of establishing a single Federal grant auditing agency.

The committee has learned that some States and local governments, particularly those that conduct "governmentwide" audits, feel that dealing with a different Federal cognizant agency for each State or local agency makes the auditing process unnecessarily complex and cumbersome. In response to this concern, OMB has taken steps intended to streamline interactions between grant recipients and Federal audit agencies. As mentioned earlier, in assigning cognizant agencies to the 300 largest general purpose local governments, OMB has designated one Federal agency to serve as the "lead cognizant agency" in those instances in which a government assigned more than one cognizant agency chooses to define the "organization" to be audited as the entire governmental unit,

rather than individual departments or agencies. The committee understands that OMB is also currently implementing the lead cognizant agency process in Tennessee, Maryland and Georgia. In addition, as noted earlier, OMB assigned one Federal cognizant agency for the entire State government of Montana, though the committee has learned that the State has subsequently decided to conduct its audits on an agency-by-agency basis. However, OMB is continuing experimentation with the concept of one cognizant Federal agency for an entire State government, this time in Delware.

The committee understands the desire of State and local governments to streamline and simplify their interactions with Federal cognizant agencies when arranging for single audits. Assigning either one cognizant agency or a lead cognizant agency to those governments requesting it appears to be a promising means of achieving this goal. The committee therefore recommends that GAO evaluate these alternative cognizant agency arrangements to determine whether it would be desirable to expand their use.

The committee is uncertain as to whether it would be feasible to establish a single Federal grant auditing agency to replace the current cognizant agency system. However, in light of the interest expressed in such a agency by State and local auditors,the JFMIP, and the GAO, the committee believes it would be useful to explore this alternative in greater depth. The committee therefore recommends that GAO also evaluate the feasibility and desirability of establishing a single Federal agency to administer the single audit process.

However, regardless of the organizational structure chosen to implement Attachment P, it is essential that this policy be administered as uniformly and consistently as possible. The committee therefore recommends that OMB establish suitable review procedures to assure the uniform interpretation and implementation of Attachment P by all Federal agencies.

B. TO WHAT EXTENT HAS ATTACHMENT P OF CIRCULAR A–102 BEEN SUCCESSFULLY IMPLEMENTED?

Exıent of implementation

Despite the fact that Attachment P to Circular A–102 was issued over two and one-half years ago, the single audit process has not been widely implemented. According to data reported to OMB from Federal agencies, as of September 1981, 59 single audits had been completed and another 108 were in progress.[36] However, Harold Steinberg, OMB Associate Director for Management, stated that these figures probably understate the actual number of single audits considerably because some grant recipients have initiated audits without notifying their Federal cognizant agency. Mr. Steinberg noted that those grant recipients who are not yet arranging for single audits continue to be audited on a grant-by-grant basis.

An informal phone survey of State auditors conducted by Val Oveson, State Auditor of Utah, also indicates that implementation of Attachment P has been rather limited. According to Mr. Oveson, as of March 1982, only 17 States had completed single audits. In

[36] Hearings, page 137.

addition, he minimized the importance of these audits, stating "It is critical to realize that these completed audits were of individual departments and many of these were performed on minor agencies." [37] Mr. Oveson concluded, "We feel that implementation of attachment P has been minimal." [38]

Definition of a single audit

According to Mr. Oveson, one of the most significant problems hampering implementation of Attachment P to Circular A-102 is a lack of consensus among Federal, State and local officials concerning the scope and coverage of a single audit: [39]

> During the last two years, I have been involved in numerous meetings with the principal players in the single audit process: OMB, GAO, Inspectors General, state auditors, local auditors, and the AICPA. I have been amazed at the divergence of opinion with respect to the definition of what a single audit is, how it is to be conducted, and what its end product should look like. What is even more disappointing is that whatever agreement has been achieved during that period seems to be superficial and transparent.
>
> The Inspectors General and, more importantly, their subordinates around the country who are responsible for working with the state and local auditors, are talking about grant auditing performed by the state and local auditors in lieu of the audits by federal auditors. What is worse, there is little agreement among these many regional representatives. The state and local auditors are talking about a single financial audit of the entire state government expended to include compliance features of the federal grants. At first glance, there does not appear to be much difference, but as one looks closer, the differences become almost insurmountable.
>
> One of the roots of the miscommunication is the fact that federal government auditors have done very little financial auditing and have limited knowledge of generally accepted accounting principles or of generally accepted auditing standards as published by the AICPA. Therefore, they have a limited frame of reference when speaking of financial auditing. In contrast, the state and local auditors do not perform grant compliance audits in the way the federal government is accustomed.
>
> Two important documents have been produced during the last year designed to settle these disagreements. The documents I am referring to are the *Questions and Answers* prepared by OMB and the *Cognizant Audit Agency Guidelines* developed and approved by the Federal Inspectors General.
>
> The concept of single audit is spelled out very clearly in the *Cognizant Audit Agency Guidelines,* but still, we disagree because of our different frame of reference. While

[37] Hearings, page 72.
[38] Ibid.
[39] Hearings, page 69.

> the two documents mentioned above are factually accurate they still have been left vague enough to spawn divergent impressions. Again this points to the need for federal legislation. OMB A-102, Attachment P, carries the weight of administrative law, but that is either not good enough or its has not been pursued aggressively enough by OMB.

In discussing the compliance component of single audits, both Mr. Oveson and Patrick Glisson, Director of Finance for De Kalb County, Georgia, complained that Federal cognizant agencies have required an excessive amount of compliance auditing. In Mr. Oveson's words: [40]

> * * * The Inspectors General, as I have seen, have wanted to heap loads of compliance work on the State and local auditors—State auditors—I will speak for the States in the rest of this testimony—they have heaped those on us and there aren't enough auditors in this country, and consequently not enough money in this country to do the kind of compliance audit work that I see some of the Inspectors General wanting to have us do.
>
> Nor do I think it is necessary. I think it is totally a waste and is overauditing, the degree of work some of the IG's are proposing that we do.

While vigorously disputing Mr. Oveson's statement that Federal auditors are unfamiliar with generally accepted accounting principals and auditing standards, James Thomas and Joseph Welsch, Inspectors General of the Department of Education and the Department of Transportation, respectively, did acknowledge that Federal auditors emphasize different aspects of a financial and compliance audit than State and local auditors. According to Mr. Thomas: [41]

> * * * From the Federal perspective we are interested in whether or not the moneys that the Federal Government appropriates are being spent for the purposes intended.
>
> We are not terribly concerned about the overall opinion on financial statements. That is of secondary interest to us. We are concerned about whether Federal money is used for purposes for which the Congress of the United States appropriated those funds, and whether their use complies with the rules, regulations, and laws of this country. Whether or not the financial statements present fairly the financial transactions of an entity is of little or no importance to us. I think, having recognized we [Federal auditors and State and local auditors] have different points of interest, we are both very capable of doing the kinds of things that we did do.

A clear understanding among Federal, State and local officials regarding the scope and coverage of a single audit is essential to insuring implementation of Attachment P. In this connection, Harold Steinberg, OMB Associate Director for Management told the subcommittee that the single audit guide, currently being re-

---

[40] Hearings, page 53.
[41] Hearings, page 179.

vised by the AICPA in conjunction with OMB, GAO and the Federal Inspectors General, will provide extensive guidance concerning the sampling of individual grants in a single audit. However, Mr. Steinberg pointed out that while the sampling guidelines will be "quite definitive" and include examples of different types of acceptable sampling plans, the technique used in a given audit will depend upon such factors as the amount of Federal funds involved and the strength of the grant recipient's internal control systems. According to Mr. Steinberg, the decision as to what sampling approach to use must ultimately rely on the professional judgment of the Federal cognizant agency and the auditor performing the audit. In his opinion, it would be inappropriate to mandate a uniform method to be used in all single audits.

Such documents as the single audit guide, the compliance supplement, the JFMIP guidelines for cognizant agencies, and the OMB "question and answer" booklet are important mechanisms for providing information on the requirements of Attachment P to Circular A-102. The committee therefore urges OMB to insure that these documents are as specific and unambiguous as possible.

Meeting Federal audit needs

In a written statement submitted for the hearing record, Thomas McBride, the Inspector General of the Labor Department, expressed concern that the single audit reports submitted to his office have been of limited usefullness: [42]

> Instead of specific information on such fundamentals as what grants were audited, how much testing and sampling was done, and what compliance coverage was provided, the reports contained a dearth of detail, a lot of unclear technical jargon, and only general assurances that no problems existed. * * *

The Inspectors General of the Departments of Education and Transportation told the subcommittee that their offices have experienced similar problems with some single audit reports. They attributed the problems with these reports primarily to the fact that Federal cognizant agency staff had not participated in the planning stages of the audits. Mr. Thomas, the Education Department's Inspector General, noted that in some instances a recipient's audit is "60 or 70 percent complete" before his office becomes aware that the audit has been initiated. At that point, it can be difficult to make changes that may be needed for the audit to satisfy Federal requirements. Despite such problems, the Inspectors General testified that their offices have rejected very few single audit reports. However, Mr. Thomas noted that some reports have required revision before being accepted, "oftentimes with the caveat they did not fully measure up to what is required by A-102-P.* * *." [43]

As noted earlier, in October 1981 the Joint Financial Management Improvement Program issued "cognizant Audit Agency Guidelines Under OMB Circular A-102 Attachment P," which spells out the role and responsibilities of cognizant agencies. The

[42] Hearings, page 160.
[43] Hearings, page 183.

guidelines emphasize the importance of Federal participation in the planning stages of single audits: [44]

> Paragraph 14c, Attachment P states that the cognizant agency shall have the responsibility to:
>
> "Provide technical advice and act as a liaison between Federal agencies, independent auditors and recipient organizations."
>
> Perhaps more than any other factor, a clear understanding of Attachment P requirements by both recipient organizations and their auditors will help ensure quality organization-wide audits. The provision of technical advice to recipient organizations and their auditors contributes to such clear understanding.
>
> Technical advice should be provided by cognizant audit agencies "up front" when they initiate their contacts with recipient organizations and their auditors. It should also be provided on a continuing basis thereafter, as needed. Cognizant audit agencies should also work with professional organizations to foster education in and understanding of audit requirements pertaining to organization-wide audits.* * *
>
> Each cognizant audit agency should formally establish audit liaison arrangements with each recipient organization for which they have cognizant agency responsbility. In establishing this liaison, recipient orgnaizations should be informed in writing of their responsbilities to obtain an audit performed in accordance with requirements set forth in Attachment P, OMB Circular A-102 * * *.

Since State or local government agencies often receive grant funds from more than one Federal agency, the guidelines also state that a cognizant agency should maintain liaison with other funding agencies to insure that single audit reports meet their needs. This liaison is particularly important when one Federal agency is serving as either the "lead" cognizant agency or the "sole" cognizant agency for an entire State or local government. In the following exchange, Inspector General Welsch discussed this issue with Dr. Goldberg of the subcommittee staff: [45]

> Mr. WELSCH. * * * as your prior witness indicated, we are the cognizant agency for the State of Maryland. That audit will be done in 1983. We have already met two or three times with the State representatives and the public accounting firm involved to discuss the audit philosophy and the compliance requirements for Federal programs, so we do have a lot of up-front involvement.
>
> Dr. GOLDBERG. Where you are the cognizant agency for an entire State, is there some mechanism by which representatives of other departments that provide assistance to Maryland have an equal opportunity to participate in that kind of a front-end conference?

---

[44] Joint Financial Management Improvement Program, "Cognizant Audit Agency Guidelines Under OMB Circular A-102 Attachment P," October 1981, page 11.

[45] Hearings, page 177.

> Mr. WELSCH. Yes, our responsibility as cognizant agency is to contact all of the Federal agencies, the Inspectors General activities, that have funds involved in the State of Maryland, and get any input that they have as far as sensitive areas or areas where they want to devote more attention. We will be meeting with them and we will have them at some joint meetings with the State and the public accounting firm involved.
>
> We do have coordinated participation.

Inspector General Thomas, whose office is the cognizant agency for the State of Delaware, indicated that his staff is involved in similar preparations for a statewide audit of that State.

The committee believes that coordination between Federal agencies concerning their audit needs and Federal participation in grant recipients' preparations for single audits can help insure that audit reports satisfy Federal user needs. In addition, these "up front" consultations should reduce both the amount of staff effort spent revising audit reports and the need for followup audits by Federal auditors, thereby helping to achieve a more efficient use of audit resources for all governments involved. The committee therefore recommends that OMB take appropriate actions to insure that Federal cognizant agencies implement the liaison and technical assistance provisions of Attachment P and the cognizant agency guidelines.

Meeting State and local audit needs

The single audit approach is intended to produce an organizationwide audit that meets the needs of all levels of government—Federal, State, and if applicable, local. However, testifying on behalf of the Municipal Finance Officers Association, Patrick Glisson, Director of Finance for De Kalb County, Georgia, stated that many of the single audits initiated to date have been focused on satisfying Federal requirements, while being "only minimally concerned with determining and demonstrating compliance with state and local government prescribed finance-related legal and contractual provisions." [46] The JFMIP Single Audit Steering Committee's task force on "uniform criteria for single audits" examined the issue of meeting State and local compliance needs within the framwork of the single audit. In November 1981, the Steering Committee adopted the following position: [47]

> State and local compliance concerns are a State and local responsibility and should be so initiated. Compliance requirements of State and local governments should be incorporated as part of any engagement agreement with the government's auditor on all attachment P audits made. Audit costs associated with coverage of State and local; compliance requirements are to be borne by State and local governments.

---

[46] Hearings, page 46.

[47] JFMIP Single Audit Steering Committee, *Position Statement, Title: Uniform Criteria for Single Audits.*

In this same connection, Comptroller General Bowsher testified that while Attachment P defines the audit needs of the Federal Government, "similar definition of users' needs would also be required of State and local governments" to help insure that the single audit approach meets the needs of all levels of government.[48]

The committee believes the single audit process can achieve its full potential as a management tool only if it produces audits that satisfy the needs of all governments involved. However, State and local officials have the responsibility for insuring that their own audit needs are incorporated into single audit plans.

Reimbursement for audit costs

In testimony before the subcommittee, Val Oveson, State Auditor of Utah, and Patrick Glisson, Director of Finance for De Kalb County, Georgia, identified problems involving the reimbursement of State and local auditors for the costs of auditing Federal grant programs as perhaps *the* major stumbling block to implementation of the single audit process. While the Federal Government currently provides reimbursement for auditing expenses through the indirect cost allocation process prescribed by OMB Circular A-87, these witnesses criticized this method as ineffective. Mr. Oveson maintained that "without direct reimbursement the chances of the single audit process succeeding are minimal * * *." [49] In this connection, the National State Auditors Association and some other organizations representing State and local officials have called for direct reimbursement of audit costs.

OMB Circular A-87 ("Principles for Determining Costs Applicable to Grants and Contracts With State, Local, and Federally Recognized Indian Tribal Governments") prescribes uniform governmentwide standards for determining which costs incurred by recipients in administering Federal grant programs are "allowable;" those determined to be allowable may properly be paid from grant funds. The Circular states, "The cost of audits necessary for the administration and management of functions related to grant programs is allowable." [50] Audit expenses are generally treated as an indirect cost, which grant recipients may recover from grant funds through an indirect cost allocation process. Circular A-87 outlines the basic provisions of the process, but the Department of Health and Human Services is responsible for developing and issuing the instructions for use by grantees in preparing cost allocation plans.

The HHS instructions provide grant recipients with several alternative methods of preparing their cost allocation plans, however, a brief description of the basic process at the State government level is included here as an example. A State includes its audit expenses and other "central agency" costs (e.g., budgeting, data processing, and purchasing) is a statewide cost allocation plan that indicates how these indirect costs are distributed among its individual operating agencies. HHS is responsible for approving each State's statewide cost allocation plan. Once HHS approves a State's alloca-

[48] Hearings, page 32.
[49] Hearings, page 50.
[50] OMB Circular A-87 (Revised), Attachment B, page 4, January 15, 1981.

tion plan, each State operating agency combines its share of the allocated central agency indirect costs with its own internal indirect costs to develop a composite indirect costs rate proposal. This rate represents total applicable indirect costs as a percentage of the agency's direct costs (generally defined as either direct salaries and wages, or direct salaries and wages plus fringe benefits). The proposed rate must then be submitted to a designated Federal agency for approval. Once approved, the indirect cost rate is applied to the State agency's Federal grant awards to determine the amount of reimbursement for indirect costs.

Circular A-87 does *not require* grant recipients to prepare cost allocation plans and indirect cost proposals. Instead, it states that grantees must prepare such plans and proposals if they wish to be reimbursed for the indirect costs they incur in administering Federal grant programs. The Circular also does *not require* Federal agencies to reimburse grantees for indirect costs; it is intended simply to establish uniform governmentwide principles for determining those costs that may appropriately be charged to Federal grants.

A few Federal grant programs have statutory limitations on the amount of indirect costs that may be allowed. With respect to such situations, Circular A-87 states: [51]

> When the amount allowable under a statutory limitation is less than the amount otherwise allowable as indirect costs under this Circular, the amount not recoverable under a grant may not be shifted to another federally-sponsored grant program or contract.

Reports by the General Accounting Office, the Joint Financial Management Improvement Program, and others have indicated that the cost allocation process prescribed by Circular A-87 has not been a fully effective means of providing Federal reimbursement for the costs incurred by State and local governments in auditing Federal grant programs. A 1975 GAO report, "Problems in Reimbursing State Auditors for Audits of Federally Assisted Programs" concluded: [52]

> Federal policy allows State audit costs to be charged against federally assisted programs, but State auditors are having difficulty in obtaining reimbursement * * *.

The report indicated that the principle factor restricting the effectiveness of the indirect cost allocation process as a reimbursement mechanism is that Federal and State program administrators, who often are reluctant to use program funds for indirect costs, have discretion over whether such costs will be paid: [53]

> FMC 74-4 [Circular A-87] recognizes State audit costs as allowable charges against federally assisted programs and provides a process to allocate audit and other costs to benefited programs. It does not, however, dictate the

---

[51] OMB Circular A-87 (Revised), Attachment A, page 10, January 15, 1981.
[52] U.S. General Accounting Office, "Problems in Reimbursing State Auditors for Audits of Federally Assisted Programs," FGMSD-75-22, June 25, 1975, page i.
[53] Ibid., page 7.

extent to which the Federal Government will provide funds for audit costs or any other allowable costs. It also does not provide additional Federal money for paying allowable costs. Thus States with approved cost allocation plans are not automatically provided with Federal funds for the Federal share of allowable costs chargeable to federally assisted programs. Each Federal program administrator can decide whether to make funds available and each State program administrator can decide whether to charge allowable costs against the program.

In 1980, in response to a request from OMB, the Department of Health and Human Services conducted a four-state study to obtain information on the extent to which States were recovering audit costs allocated to Federal grant programs under Circular A-87. The results of this review, presented below, appear to confirm GAO's finding that States have not been receiving full reimbursement for their audit costs.

STATE AUDIT COSTS REIMBURSED BY THE FEDERAL GOVERNMENT

[Fiscal year 1980]

	Illinois	Missouri	Tennessee	Virginia
Total audit costs included in statewide cost allocation plan	$4,430,000	$653,000	$2,818,000	$1,101,000
Total estimated maximum potential recovery of State audit costs from the Federal Government	586,000	213,000	291,000	55,000
Total estimated actual recovery of audit costs	310,000	24,000	[1] 88,000	([2])
Percentage actually recovered	53	11	30	.....

[1] The State recovered an additional $820,000 in audit costs by contracting directly with the Federal Government.
[2] The amount actually recovered could not be readily determined or estimated.

HHS identified three reasons for the relatively low recovery rates for audit costs in the four States examined in its review.

Many State agencies had not established an indirect cost rate, either because the amount of indirect costs involved was very small, or because Federal grant agencies were reluctant to provide reimbursement for indirect costs.

In some instances, State agencies had opted to forego reimbursement for indirect costs in order to spend a large portion of their grant money on direct program activities.

In preparing their indirect cost proposals, some State agencies had included only their own internal indirect costs, and had failed to include the central agency costs allocated to them in their State's statewide cost allocation plan.

Various alternatives to the indirect cost allocation process have been suggested as methods of providing reimbursement to State and local auditors. While not recommending the adoption of any specific reimbursement procedure, a 1975 GAO report, entitled "Problems in Reimbursing State Auditors for Audits of Federally Assisted Programs," noted that some Federal agencies had obtained audits of Federal grant programs by contracting directly with State auditors, and suggested that this approach might be an effective means of providing reimbursement. GAO stated, however,

"We do not take the position that direct contracting is the only acceptable method of reimbursing State auditors." [54]

The 1979 JFMIP study, "Report on Audit of Federally Assisted Programs: A New Emphasis," which urged adoption of the single audit approach, recommended that reimbursement be provided through a "set-aside" procedure. Under this method, grant recipients would be required to certify that grant funds had been budgeted and would be reserved for financing part of the required single audit.

The JFMIP Single Audit Steering Committee established a task force to examine the reimbursement issue. In an August 1981 "position paper" the task force evaluated three methods of providing reimbursement: (1) the current indirect cost allocation process; (2) direct reimbursement from a special "audit appropriation" to the cognizant Federal agency; and (3) a "grant set-aside" process under which each Federal grant agency would set aside a portion of each grant for audit reimbursement purposes. The task force did not make a specific recommendation, but indicated that either of the latter two methods would be "viable." The Steering Committee did not take an official position on this issue.

The committee has learned of two recent developments that may help improve audit reimbursement procedures. First, according to OMB, several State and local governments either have developed, or are in the process of developing, their own statutory or administrative "set-aside" procedures or earmarking grant funds for audit purposes. The committee notes that while this approach necessitates action by individual State and local governments rather than relying on a single uniform Federal policy, it appears to allow grant recipients the flexibility to design a reimbursement process suited to their own particular circumstances. Second, OMB has revised the indirect cost allocation process prescribed by Circular A-87 to allow State departments and agencies the option of developing a separate indirect cost rate reflecting audit costs only. An agency exercising this option could thus have two indirect cost rates—one for audit costs, and another for "other" indirect costs.

The committee views OMB's revisions in the indirect cost allocation process as a potentially effective means of facilitating reimbursement of State auditors. However, according to testimony by the Municipal Finance Officers Association, local auditors have also experienced difficulty in obtaining reimbursement for audit costs. The committee therefore recommends that OMB make the option of developing a separate indirect cost rate for audit expenses available to local governments as well as State governments.

While developing a separate indirect cost rate should enable State and local governments to identify their audit costs more accurately, this change does not address the reluctance of program administrators to spend grant funds for indirect costs. In this connection, Val Oveson, State Auditor of Utah, called for Federal regulations "to force program people to allocate funds for audit and then actually get the money to the auditors to do the work * * *." [55]

---

[54] Ibid., page 16.
[55] Hearings, page 57.

With respect to the reluctance of State and local officials to charge audit costs to Federal grants, it is the committee's view that this is an internal matter that each unit of government must resolve for itself. The committee does not believe it appropriate for the Federal Government to require State and local governments to charge audit expenses to their Federal grants. However, when recipients elect to charge audit costs through approved cost allocation plans and indirect cost proposals, those costs should be reimbursed. Therefore, except where indirect costs are limited by statute, the committee recommends that all Federal agencies reimburse audit costs in accordance with the provisions of Circular A-87 and the cost allocation guidelines issued by the Department of Health and Human Services.

C. WILL IMPLEMENTATION OF THE SINGLE AUDIT RESULT IN COST SAVINGS TO THE FEDERAL GOVERNMENT AND TO OTHER GOVERNMENTAL UNITS INVOLVED?

In discussing the potential cost impact of the single audit approach, Comptroller General Bowsher noted that: [56]

> * * * we are still in the learning process and relatively few single audits have been performed to date. Those that have been done have not been sufficiently analyzed to establish a clear indication of cost savings to be realized or other benefits to be achieved. It is obvious, though, that the old approach, in which audit resources were being expended for narrowly scoped individual grant audits, led to a highly disorganized effort with many gaps in coverage and inefficiencies.
>
> To the extent that the single audit is performed at the entity level and addresses controls on a systems basis for all grants, we are convinced it will be a more cost effective approach than the grant-by-grant approach under which some grants were never audited at all.

Mr. Bowsher indicated that GAO is currently evaluating the implementation of the single audit process, and that this study will include an effort to develop more extensive cost data.

Several witnesses noted that increased reliance on audits performed by non-Federal auditors will likely result in a more efficient and effective use of Federal audit resources, as Inspectors General will be able to utilize their staff to evaluate the economy and efficiency, and the results of Federal grant programs, and to perform internal audits of Federal agencies. In the opinion of Joseph Welsch, Inspector General of the Department of Transportation, internal audits: [57]

> * * * will result in greater audit benefits because evaluations and recommendations will be directed towards management systems and program administration. Improvements in these areas are of greater value than costs questioned through external grant audits.

---

[56] Hearings, page 32.
[57] Hearings, page 173.

Witnesses indicated that it is difficult to predict with confidence whether implementation of the single audit will achieve cost savings for the Federal Government resulting from improved identification of funds misspent by grant recipients. Since the auditing of individual grants is less detailed under the single audit approach than under grant-by-grant auditing, single audits may produce smaller amounts of "questioned costs" per grant. However, since the organizationwide scope of single audits will provide coverage for a much higher percentage of Federal grants, the total amount of questioned costs may be greater than under the grant-by-grant approach. Harold Steinberg, OMB Associate Director for Management, stated that, in his opinion, the single audit approach will likely achieve better identification of questioned costs involving "cross-cutting weaknesses in internal control systems" than would be possible under narrowly-focused grant-by-grant auditing.[58]

With respect to the cost impact of the single audit process on State and local government, witnesses representing the Federal Government indicated that grant recipients will likely achieve cost savings resulting from a reduction in the duplication and overlap that has characterized grant-by-grant auditing, in part because their staffs will not be disrupted by numerous teams of auditors. Harold Steinberg stated that in connection with its single audit implementation plan, OMB will be attempting to determine how much these cost savings could amount to. However, Val Oveson, State Auditor of Utah, presented a different view. Noting the problems that State and local auditors have experienced in obtaining reimbursement for audits of Federal grant programs, Mr. Oveson stated, "It is our feeling that the single audit will not result in cost savings to the State and local governmental units unless some form of direct reimbursement is provided.[59]

The committee believes the single audit process has the potential for achieving a more effective and efficient use of audit resources than the traditional grant-by-grant approach. However, there is currently a lack of reliable information concerning the potential cost impact of the single audit on Federal, State and local governments. The committee believes it is important to determine whether the broader coverage envisioned by the single audit will entail substantially greater costs for the participating governments, or whether the intended reduction of audit duplication and overlap will in fact produce significant offsetting savings. Both GAO and OMB have testified that they intend to develop more comprehensive cost data on the single audit. The committee urges GAO and OMB to expedite the development of this important information.

D. IS LEGISLATION MANDATING THE SINGLE AUDIT PROCESS NECESSARY OR ADVANTAGEOUS AT THIS TIME?

In testimony before the subcommittee, representatives of State and local auditors expressed strong support for legislation mandating the single audit process. While acknowledging that there are many significant problems currently hampering implementation of

[58] Hearings, page 154.
[59] Hearings, page 71.

the single audit, they charged that under Attachment P of Circular A-102, OMB has been either unable or unwilling to provide the strong leadership necessary to resolve these issues. These witnesses also argued that legislation is necessary to provide OMB with both the authority and the motivation to insure its implementation.

Val Oveson, State Auditor of Utah, expressed the need for legislation as follows: [60]

> * * * Until we have a clear consistent agreement as to how audits will be done, what the audit report should look like, who will pay for the cost and what will happen to those State and local governments who do not comply, I don't think we are going to go anywhere. I think Federal legislation is the only way we are going to get single audit off dead center.
>
> I am speaking of both of the bills that are before your committee at this time. There are amendments and changes that would need to take place to accomplish the things that I have suggested, but I think Federal legislation is definitely desirable and necessary.

While generally expressing strong support for the single audit concept, witnesses representing the Federal Government testified that legislation mandating the single audit would not be appropriate at this time. In the following exchange with subcommittee Chairman Fountain, Comptroller General Bowsher expressed his reservations about enacting legislation without further experience with Attachment P: [61]

> Mr. FOUNTAIN. * * * You stated that you thought the legislation in question would be premature at this time. I gather from your statement and your responses to our questions that you feel we haven't gone far enough with the implementation of the single audit concept to be able to know precisely what form the legislation should take and what the results would be if it is not properly written. Is that right?
>
> Mr. BOWSHER. That is correct, Mr. Chairman. I think in another few months to a year we will know a lot more. When legislation is being considered, I think you should have a program of enough experience so that you prevent major mistakes in implementation. I don't feel comfortable enough at this time to recommend legislation.
>
> We have to get more facts and experience and see what is happening on single audits that are being performed.

Mr. Bowsher also stated: [62]

> Since Attachment P was issued in October 1979, OMB has focused on defining the Federal user needs to be addressed by the single audit. Nevertheless, much remains to be done before it becomes fully operational as the generally accepted way of performing an audit.

---

[60] Hearings, page 53.
[61] Hearings, page 38.
[62] Hearings, page 32.

Some of the more crucial issues yet to be resolved relate to the following questions.

First, how will we get a mutual understanding of the expectations to be derived from a single audit by all Federal, State, and local users?

Second, what is the role of the cognizant Federal agency in working with the auditor and auditee in agreeing on the scope of the audit?

Third, what is the role of the cognizant agency in testing the quality review process and how will it be performed?

Fourth, since the single audit approach focuses on the overall financial integrity and internal system control improvements, what alternative mechanisms are needed, if any, to assure possible congressional expectations concerning compliance with the more detailed requirements of the individual grant programs?

Fifth, is it feasible to mandate that all entities and subrecipients be subject to the single audit? For example, there are some 300 cities and counties that receive about 66 percent of Federal assistance. Is it more feasible to target initial efforts to the 50 States and 300 [largest] cities and counties?

Sixth, what is the Federal share, if any, of costs associated with the single audit?

Harold Steinberg, OMB Associate Director for Management, also questioned the desirability of legislation mandating the single audit at this time: [63]

> In short, I guess I would say that the implementation of the single audit is going well. This administration is very committed to it. State and local governments by and large are moving to accommodate it. The public accounting profession is learning how to adopt its procedures to meet the needs of the single audit. Therefore, I do not think that legislation would be appropriate until such time as the process is evolved and then only if there is evidence or reports of flagrant abuses or violations.

The reservations of the Federal Government witnesses were perhaps best summarized by Joseph Welsch, Inspector General of the Department of Transportation, who stressed the need for "administrative flexibility" in implementing the single audit process. Mr. Welsch said: [64]

> Although we are making significant progress in implementing the single audit concept, there are complicated and difficult procedural, organizational, and administrative problems to be worked out.
>
> The variations in size, complexity, and organizational structures involved in Federal, State, and local governments makes it essential that administrative flexibility be retained in order to insure appropriate and reasonable im-

[63] Hearings, page 128.
[64] Hearings, page 172.

plementation of the single audit concept considering the circumstances involved in each situation.

Based on my experience as Inspector General of the Department of Transportation, and our evaluation of the single audit concept within the Department, my recommendation is to continue to aggressively pursue implementation of the single audit concept under the administrative requirements of OMB Circular A-102.

This provides a flexible vehicle to address the many and varied implementation issues. Therefore, I do not support either bill as being necessary or beneficial for furthering the implementation of the single audit concept.

In fact, the bills could inhibit and make difficult the implementation of a prudent, sound, and reasonable approach to assure adequate audit reviews of federally supported programs.

In a 1979 report, the committee endorsed the single audit concept as a means of achieving more efficient and effective auditing of Federal assistance to State and local governments, and recommended that the Office of Management and Budget take specific actions to insure its implementation.[65] After reviewing the implementation of Attachment P to Circular A-102, the committee reaffirms its support of this very promising approach. However, the committee finds that while considerable progress has been made towards developing the basic administrative procedures and guidance documents, relatively few single audits have actually been completed and many unresolved problems currently hamper widespread adoption of this method. It is the committee's view that further experience with Attachment P is desirable before Congress enacts legislation for this purpose. The committee anticipates in this connection that the current work of OMB and GAO in monitoring and evaluating implementation of Attachment P will provide valuable information for designing appropriate single audit legislation.

---

[65] House Report No. 96-580, 96th Congress, 1st Session, November 1, 1979, "Failure To Provide Effective Audits of Federal Grants."

ADDITIONAL VIEWS OF HON. JOHN N. ERLENBORN, HON. FRANK HORTON, HON. CLARENCE J. BROWN, HON. THOMAS N. KINDNESS, HON. ROBERT S. WALKER, HON. JOEL DECKARD, HON. WILLIAM F. CLINGER, JR., HON. RAYMOND J. McGRATH, HON. JOHN HILER, HON. JUDD GREGG, AND HON. MICHAEL G. OXLEY

While we supported the adoption of the report on the single audit of federal assistance programs, we must express some reservations about some aspects of the report.

In July of last year, Representative Erlenborn (R-Ill.), introduced H.R. 4133, a bill that would give a statutory basis for the implementation of the single audit requirements contained in Attachment P of OMB Circular A-102.

As cosponsors of this or similar legislation we felt then, and still feel, that legislation is necessary for two reasons. First of all, federal agencies and departments have been unwilling or unable to fully comply with the single audit requirements of Attachment P. As the hearings of the Subcommittee bore out, some federal departments are just plain unwilling to forsake their own narrow needs for the sake of the overall improvements in fiscal accountability a fully effective single audit would bring. And the fact is that an OMB Circular just is not strong enough to force them to mend their ways—a bill is needed.

Secondly, many state and local auditors have had little success in receiving just compensation for the audit work they perform relative to federal assistance. The direct reimbursement provision contained in H.R. 4133 would put an end to this by insuring that the auditors would receive payment for services rendered.

Yet, we understand the hesitancey on the part of the Committee to move at this time and note its strong support for the single audit. We hope this Committee will continue its work in this area and, as the report suggests, work with OMB and GAO to develop the technical expertise which will enable us to write and enact suitable legislation at a later date.

JOHN N. ERLENBORN.
FRANK HORTON.
CLARENCE J. BROWN.
THOMAS N. KINDNESS.
ROBERT S. WALKER.
JOEL DECKARD.
WILLIAM F. CLINGER, Jr.
RAYMOND J. McGRATH.
JOHN HILER.
JUDD GREGG.
MICHAEL G. OXLEY.

O